

**Business Tax Returns Were Successfully  
Processed in Two Locations in 2002;  
However, Taxpayers Need More Information  
on Where to File**

**December 2002**

**Reference Number: 2003-30-038**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

December 23, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Business Tax Returns Were Successfully  
Processed in Two Locations in 2002; However, Taxpayers Need  
More Information on Where to File (Audit # 200230017)

This report presents the results of our review of issues affecting the Internal Revenue Service's (IRS) ability to process business tax returns under its new organizational structure at the two Business Submission Processing Centers located in Ogden, Utah, and near Cincinnati, Ohio.

One of the factors significant to the success of the IRS' modernization and workload transition efforts was the consolidation of business tax returns processing to two Submission Processing Centers. Calendar Year 2002 was the first year that essentially all business returns were to be processed in only two centers.

In summary, the IRS' efforts to process all business returns in these two centers were successful. As of August 10, 2002, the 2 Business Submission Processing Centers had processed over 25 million of the nation's business tax returns. These returns were not processed without problems, but management at the two centers used creative solutions to resolve many of these problems.

Despite this success, the IRS could improve the processing of business tax returns by better educating business taxpayers and their tax practitioners on where to file business tax returns. Between January 1 and August 10, 2002, over 3.6 million paper business returns were sent to the wrong Submission Processing Centers, representing 14 percent of all paper business returns filed. We found that some tax return instructions contained incorrect filing locations, and educational media did not provide sufficient information for business taxpayers on where to file. We recommend that forms, instructions, and educational materials be updated to reflect new filing locations.

We identified two other issues that, if addressed, could improve service to business taxpayers. First, the IRS could both reduce the government's costs to issue refunds to corporate taxpayers and increase taxpayer satisfaction by improving the processing of requests for direct deposits and making changes, as necessary, to U.S. Corporation Income Tax Returns (Forms 1120 and 1120-A) to make selecting the direct deposit option easier. We informed the IRS of this issue, and it took actions to improve processing. We recommend the IRS gather data to determine if the action taken resolved or significantly improved the problem of IRS employees overlooking taxpayer requests for direct deposits. In addition, the IRS should monitor the volume of direct deposit requests, and if the number of taxpayers requesting the direct deposit option remains low, consider appropriate changes to Forms 1120 and 1120-A. Secondly, we identified a computer programming problem which prevented IRS employees from identifying tax practitioners authorized to discuss taxpayers' returns. As a result, IRS employees could not honor taxpayers' wishes to discuss problems or questions regarding their tax returns with their tax practitioners. We informed the IRS about this issue, and immediate action was taken to correct the programming error.

Management's Response: The IRS agreed to revise appropriate tax form instructions and publications and to make changes to the information on its web site to provide business taxpayers with needed information regarding where to file their tax returns. As discussed, the IRS took immediate action to improve processing of requests for direct deposit of refunds. The changes will be emphasized during the training of processing employees. The IRS will use a computer program to capture the volumes of taxpayers requesting direct deposit of their refunds. If volumes do not rise significantly, further steps will be taken to increase taxpayer awareness of the direct deposit option. Management's complete response to the draft report is included as Appendix VII.

Office of Audit Comment: Although the IRS agreed to revise tax form instructions, publications, and its web site, management disagreed with our estimate of savings that could be realized by making these revisions. They stated that based on feedback received from the tax practitioner community, most of the misdirected tax returns were not the result of inaccurate "Where to File" instructions on the part of IRS, but occurred because of the following taxpayer errors:

- Continued use of outdated envelopes containing the former "Where to File" address.
- Filing a taxpayer's individual and business tax returns in the same envelope.

During our audit, we asked the IRS to provide data regarding the effect that our recommendation would have on the number of misdirected tax returns. The IRS provided no data during the audit or during discussions of the draft report. While we believe that the taxpayer mistakes cited by the IRS are caused, in part, by not having sufficient IRS information on where to file, and while we do not completely agree with the information provided by the IRS in their response, we have nevertheless revised our estimate. See Appendix IV for details of our revised estimate.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or

Parker F. Pearson, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (410) 962-9637.

**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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**Table of Contents**

Background .....	Page 1
Overall, Business Tax Returns Were Successfully Processed in Two Submission Processing Centers .....	Page 1
Taxpayers and Tax Practitioners Need Better Information on Where to File Business Tax Returns .....	Page 2
<u>Recommendation 1:</u> .....	Page 6
<u>Recommendations 2 and 3:</u> .....	Page 7
Changes to Processing Procedures or to Certain U.S. Corporation Income Tax Returns Could Result in More Corporate Taxpayers Receiving Refunds Through Direct Deposit.....	Page 8
<u>Recommendations 4 and 5:</u> .....	Page 10
A Computer Programming Problem Prevented Internal Revenue Service Employees from Identifying Tax Practitioners Authorized to Discuss Taxpayers' Returns.....	Page 11
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 12
Appendix II – Major Contributors to This Report.....	Page 14
Appendix III – Report Distribution List .....	Page 15
Appendix IV – Outcome Measures .....	Page 16
Appendix V – Sample Selection .....	Page 18
Appendix VI – Business Tax Returns (Tax Year 2001) with Authorizations for Third Party Contact.....	Page 20
Appendix VII – Management's Response to the Draft Report .....	Page 21

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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### **Background**

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As part of the Internal Revenue Service's (IRS) modernization and workload transition efforts, the IRS has consolidated the processing of business tax returns to two Business Submission Processing Centers. This transition was substantially completed during Calendar Year (CY) 2002. Because the transition to two Business Submission Processing Centers is significant to the IRS' modernization efforts, we initiated this audit to identify any issues affecting the IRS' ability to process business tax returns under this new organizational structure.

We conducted our audit from December 2001 to September 2002 in the Ogden and Cincinnati Submission Processing Centers and the IRS' Small Business/Self-Employed (SB/SE) Division's Customer Account Services Headquarters. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **Overall, Business Tax Returns Were Successfully Processed in Two Submission Processing Centers**

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As of August 10, 2002, the 2 Business Submission Processing Centers had processed over 25 million of the nation's business tax returns.<sup>1</sup> Overall, the two Centers processed the tax returns accurately and completed the processing within prescribed time periods.

While the IRS encountered some problems in processing these returns, management at the two centers used creative solutions to resolve the problems that arose. For example:

- Batch carts for storing and moving tax returns became extremely scarce at times because (1) the processing peaks for the different types of business tax returns overlapped, and (2) the two centers were still processing some individual income tax returns. The centers used a variety of methods to address the problem including borrowing shopping carts from local grocery stores.

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<sup>1</sup> The 2 Business Submission Processing Centers had also processed approximately 6 million paper individual income tax returns as of this date.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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- One center experienced a significant backlog resolving computer-identified errors on electronic tax returns. To help alleviate this center's backlog, tax examiners in the other center accessed many of the backlogged cases remotely via computer and resolved the errors.
- Many employees from the Ogden Submission Processing Center were involved in the Winter Olympics that were held when returns processing was at or near its peak. Management worked closely with those employees and their supervisors to balance the needs of the employees with those of the IRS.

Despite these successes, we identified three issues that the IRS could address to improve the processing of business tax returns. The first of these issues directly relates to the transition of business returns processing to two Submission Processing Centers. The other two issues relate to business returns processing in general.

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### **Taxpayers and Tax Practitioners Need Better Information on Where to File Business Tax Returns**

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The IRS could improve the processing of tax returns by better educating taxpayers and their tax practitioners on where to file business tax returns. Between January 1 and August 10, 2002, taxpayers and tax practitioners sent over 3.6 million paper business tax returns to the wrong Submission Processing Centers. This represents 14 percent of all paper business tax returns filed during that period. The IRS' samples of these misrouted tax returns indicated that over 60 percent were prepared by tax practitioners. We identified several possible reasons why such a high percentage of business tax returns were filed at incorrect locations.

- **Some tax return instructions contained the wrong filing locations.** The instructions on where to file the following four business tax returns were not updated to reflect the new filing locations:
  - Generation-Skipping Transfer Tax Return for Distributions (Form 706-GS[D]).
  - Notification of Distribution From a Generation-Skipping Trust (Form 706-GS[D-1]).

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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- Generation-Skipping Transfer Tax Return for Terminations (Form 706-GS[T]).
- United States Short Form Gift Tax Return (Form 709-A).

Instructions on each of these forms told taxpayers to file their returns at 1 of the 10 IRS Centers, which was the prior IRS processing structure.

- **The IRS did not consistently inform taxpayers of the new filing locations in the “Changes to Note” sections of the tax return instructions.** The instructions for many business tax forms contain a “Changes to Note” section (or a similar section) that discusses recent tax law changes or other changes of which taxpayers should be aware. This section of the instructions for many tax forms discussed the new locations for filing business tax returns. However, the “Changes to Note” sections of the following forms made no mention of the change in filing locations:
  - Employer’s Annual Federal Unemployment (FUTA) Tax Return (Forms 940 and 940-EZ).
  - Employer’s Quarterly Federal Tax Return (Form 941).
  - Employer’s Annual Tax Return for Agricultural Employees (Form 943).
  - Circular E, Employer’s Tax Guide (Publication 15).
- **The IRS’ web site, *The Digital Daily*, did not help the business taxpayer with regard to information on where to file business tax returns.** The web site contains links to web pages with information tailored specifically for individual taxpayers, business taxpayers, tax professionals, charities and non-profit organizations, government entities, and retirement plans. Each of these web pages contains a link entitled “Where to File.”

Picture 1 shows the web page designed for business taxpayers.



## Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File

Picture 1 – Businesses Page (*The Digital Daily*)



By clicking on the “Where to File” link under the “resources” heading in the left-hand margin, taxpayers are taken to the web page shown in Picture 2.

Picture 2 shows the web page which appears when taxpayers click on the “Where to File” link from the business web page.<sup>2</sup> Regardless of which of the specially tailored web pages the taxpayer is viewing, the “Where to File” link takes the taxpayer to the same web page with detailed instructions and addresses for filing individual tax returns. This web page tells business taxpayers to refer to the respective tax packages for the locations at which to file their tax returns.

<sup>2</sup> This same web page is displayed when clicking on the “Where to File” link on the web pages labeled individuals, businesses, charities and non-profits, government entities, tax professionals, and retirement plans.

**Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

**Picture 2 – Where to File (*The Digital Daily*)**



By clicking on any of the states in this picture, taxpayers are taken to a web page with the following statement:

**Where to file your federal tax return:**

(For Individual Form 1040 filers **ONLY**. If you are filing a business return see *Where To File* addresses in the tax package instructions.)

- **Other IRS educational materials similarly did not assist business taxpayers.** For example, a news release issued by the IRS on August 9, 2002, entitled, “IRS Provides Center Addresses to Tax Professionals,” discussed the redistribution of workload among the IRS’ Submission Processing Centers and again provided addresses only for individual tax returns. In addition, an e-mail service from the IRS, *IRS Digital Dispatch*, issued a message on August 13, 2002, again providing a link to the addresses for preparers of individual tax returns, but with no similar information for business tax returns.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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Part of the IRS' mission is to help all taxpayers understand and meet their tax responsibilities. Without improved and continued education on the proper locations at which to file their paper business tax returns, both taxpayers and tax practitioners will most likely continue to send their business tax returns to the same location they have sent them in the past.

Even taxpayers who are aware of a change and who are looking for information to help them file in the correct location may become frustrated. For example, a tax practitioner advised us that she had contacted the IRS specifically to complain about not having information on the change in filing locations for business tax returns.

Since only two IRS Submission Processing Centers are now prepared to process business tax returns, any such returns sent to one of the other eight centers must be boxed and shipped to the appropriate center. We estimate the cost of preparing and shipping these documents could be reduced by \$238,000<sup>3</sup> per year with greater emphasis on taxpayer education. (See Appendix IV for details.)

### **Recommendations**

1. The Director, Tax Forms and Publications, Wage and Investment (W&I) Division, should ensure that the following changes are made to IRS forms and publications:
  - Update the instructions on where to file Forms 706-GS(D), 706-GS(D-1), 706-GS(T), and 709-A.
  - Update the "Changes to Note" (or similar) section of the Forms 940 and 941 instructions to bring to the taxpayers' attention that there has been a change in filing locations.<sup>4</sup>

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<sup>3</sup> This is a revised figure based on the IRS' response to our draft report.

<sup>4</sup> IRS officials advised us that Forms 940-EZ and 943 had already gone to print at the time of our report and could not be changed for the next tax year.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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- Indicate in the appropriate section of Publication 15 that there has been a change in filing locations for employment tax returns (Forms 940, 940-EZ, 941, 943, and 945).

Management's Response: The Director, Tax Forms and Publications agreed to revise the applicable forms and the publication to inform taxpayers of the new filing locations.

2. The Director, Customer Account Services, SB/SE Division should continue to monitor the volumes of Forms 940-EZ and 943 filed in the wrong Submission Processing Centers during CY 2003 and, if the volumes remain significant, work with the Director, Tax Forms and Publications, W&I Division, to obtain updates to the "Changes to Note" (or similar) sections of these forms similar to those obtained for Forms 940 and 941.

Management's Response: Management from the Program Management/Process Assurance Branch, within Customer Account Services, agreed to continue to monitor the volumes of transshipped work by form type (including Forms 940-EZ and 943). If volumes of Forms 940-EZ and 943 are high, they will take actions to obtain updates to the "Changes to Note" sections of these forms.

3. The Director, Taxpayer Education and Communication, SB/SE Division, should ensure that paper business return filing locations are provided on the appropriate pages of the *IRS Digital Daily* web site, as well as in other appropriate IRS educational materials. At a minimum, each web page related to business tax returns should include a link to the information included on the "Tax Professional" web page.

Management's Response: The Director, Taxpayer Education and Communication agreed to make changes to the IRS' website to include a link to information on where to file business returns on each page on the website.

Office of Audit Comment: IRS management disagreed with the estimated cost savings that could be realized by taking corrective actions to recommendations 1 through 3. They stated that based on feedback received from the tax practitioner community, most of the misdirected tax returns

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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were not the result of inaccurate “Where to File” instructions on the part of the IRS, but occurred because of the following taxpayer errors:

- Continued use of outdated envelopes containing the former “Where to File” address.
- Filing a taxpayer’s individual and business tax returns in the same envelope.

During our audit, we asked the IRS to provide data regarding the effect that our recommendations would have on the number of misdirected tax returns. The IRS provided no data during the audit or during discussions of the draft report. While we believe that the taxpayer mistakes cited by the IRS are caused, in part, by not having IRS information on where to file, and while we do not completely agree with the information provided by the IRS in their response, we have nevertheless revised our estimate. See Appendix IV for details of our revised estimate.

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### **Changes to Processing Procedures or to Certain U.S. Corporation Income Tax Returns Could Result in More Corporate Taxpayers Receiving Refunds Through Direct Deposit**

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Beginning in Tax Year 2001, corporate taxpayers that were due refunds were given the option of having their refunds deposited directly to the financial institutions of their choice. A similar option has been available to individual taxpayers since the mid-1990s. This method of issuing refunds is advantageous to the government because it costs less to issue an electronic refund than a paper check; it is advantageous to the taxpayer because an electronic refund is more secure than a paper check and is received in less time.

Based on our judgmental samples, it appears that a significantly smaller percentage of corporate taxpayers than individual taxpayers received electronic refunds. As of August 9, 2002, 41 percent of all individual income tax returns claiming refunds received those refunds through direct deposit.<sup>5</sup> We selected a judgmental sample of 60 corporate tax returns at various stages of IRS processing and found that, of 19 requesting refunds, only 5 (26 percent) selected the direct deposit option, and none actually received their refund by direct deposit.

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<sup>5</sup> Based on data accumulated by the IRS’ Statistics of Income function. Similar information was not available for corporate tax returns.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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After reviewing the results of our judgmental sample, we used a computer program to identify all Forms 1120 and 1120-A processed between January 1 and September 7, 2002, claiming refunds nationwide. Of 97,068 corporate refunds claimed, only 63 were processed as direct deposits.

One probable reason is that to request direct deposit, corporate taxpayers must fill out a separate form, Direct Deposit of Corporate Tax Refund (Form 8050).<sup>6</sup> In contrast, individual taxpayers can indicate that choice directly on their U.S. Individual Income Tax Return (Form 1040) without filing an additional form. Because business taxpayers must obtain and file another tax form to select the direct deposit option, they may consciously or unconsciously overlook the option. In addition, because the direct deposit information was included on a separate form, IRS employees were overlooking it. In fact, IRS employees overlooked every taxpayer request for a direct deposit in our sampled cases. We informed the IRS about this issue on May 20, 2002. As a result, the IRS issued alerts to its processing employees and initiated a change to processing instructions.

The potential for taxpayer burden and dissatisfaction exists when the IRS does not provide taxpayers with the form of refund that they requested. For taxpayers with large refunds, the loss of interest earned can be significant if a refund is issued via paper check versus a direct deposit. In addition, the cost to the government is increased when paper checks are issued.

The IRS could increase taxpayer satisfaction by improving the processing of requests for direct deposits and changing, as necessary, Forms 1120 and 1120-A to make selecting the direct deposit option easier. Initially, individual taxpayers were required to file a separate form to select the direct deposit option, but the IRS now includes this option on the

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<sup>6</sup> Another factor causing the percentage of individual income tax returns requesting direct deposits to be higher might be the ability to file individual returns electronically, which currently is not available for corporate returns.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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Form 1040. This action would also reduce the costs associated with issuing corporate refunds.<sup>6</sup>

### **Recommendations**

4. The Director, Customer Account Services, SB/SE Division, should gather data to determine whether the actions taken to change processing procedures resolved or significantly improved the problem of IRS employees overlooking requests for direct deposit of refunds or whether additional improvements need to be made. This issue should also be addressed in training for processing employees.

Management's Response: The Director, Customer Account Services took immediate action to address the processing deficiencies discussed. The changes to processing procedures and instructions will be emphasized when processing employees are trained.

5. The Director, Customer Account Services, SB/SE Division, should monitor the volume of corporate taxpayers selecting the direct deposit option. If the number does not significantly increase after steps are taken to ensure that all direct deposit requests are properly processed, the Director should work with the Director, Tax Forms and Publications, W&I Division, to make appropriate changes to Forms 1120 and 1120-A necessary to ensure that corporate taxpayers are aware of, and can easily select, the direct deposit option. Consideration should be given to including the direct deposit option on the Forms 1120 and 1120-A in the future.

Management's Response: The Director, Customer Account Services has requested computer programming to capture the volumes of taxpayers requesting direct deposit of their refunds. If volumes do not rise significantly, further steps will be taken to increase taxpayer awareness of the direct deposit option.

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<sup>6</sup> The Financial Management Service estimates that it costs 28 cents more to issue a paper check than to complete a direct deposit.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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### **A Computer Programming Problem Prevented Internal Revenue Service Employees from Identifying Tax Practitioners Authorized to Discuss Taxpayers' Returns**

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Business taxpayers filing certain tax forms have the option to authorize the IRS and the specific tax practitioner who prepared their tax returns to discuss the returns. (See Appendix VI for a list of business tax forms containing the option for taxpayers to make this authorization.) This authorization gives the IRS permission to contact the tax practitioner to obtain answers to questions that may arise during the processing of the return. It also informs the IRS that the tax practitioner has permission to contact the IRS for information about the processing of the return or the status of any refund or payment. The IRS may not disclose any information regarding the tax return to anyone other than the taxpayer if this authorization is not present. This authorization applies only to the individual whose signature appears in the "Paid Preparer's Use Only" or the "Third Party Designee" sections of the returns. It does not apply to the firm, if any, shown in those sections.

If, during the processing of a tax return, questions arise on the part of the IRS or the tax practitioner, IRS employees use specific computer command codes to display information about the tax return on their computer screens. Among this information should be the tax practitioner authorization. However, because of a programming error, IRS computer screens were not accurately reflecting all of the data required to identify the tax practitioner authorized to discuss a taxpayer's return. As a result, IRS employees could not honor taxpayers' wishes to discuss problems or questions regarding their tax returns with their tax practitioners.

We informed the IRS about this issue on May 23, 2002. The IRS took immediate action to correct the computer programming error. Computer screens now properly display all necessary tax practitioner data.



### **Detailed Objective, Scope, and Methodology**

Our overall objective was to identify issues affecting the Internal Revenue Service's (IRS) ability to process business tax returns under its new organizational structure at the two Business Submission Processing Centers located at Ogden, Utah and near Cincinnati, Ohio. To accomplish our objective, we:

- I. Interviewed officials at the Small Business/Self-Employed Division's Customer Account Services Headquarters office and at the two Submission Processing Centers to discuss areas of concern and action plans.
- II. Discussed and/or reviewed available documentation regarding the two Submission Processing Centers' workforce, training, and work schedules.
- III. Monitored the volumes of individual and business tax returns received and processed at the two Business Submission Processing Centers to identify any significant backlogs and determine whether the volumes of returns planned for were received.
- IV. Reviewed a judgmental sample of paper business tax returns at various stages of processing at the two Business Submission Processing Centers to determine if the returns were processed correctly and if the information on the returns was accurately posted to the taxpayers' accounts on the IRS' Business Master File (BMF).<sup>1</sup> See Appendix V for details of our sample selection.
- V. Determined if the eight Submission Processing Centers assigned to process individual tax returns followed the proper transshipment procedures and guidelines in sending all business tax returns that they received in error to the two Business Submission Processing Centers and monitored the volume of transshipped returns.
- VI. Evaluated the adequacy of IRS actions to educate taxpayers and practitioners on where to file their tax returns.
- VII. Determined whether the IRS had taken appropriate steps to implement tax legislation that affected the processing of business tax returns during 2002.
- VIII. Monitored the issues discussed at production meetings at both Business Submission Processing Centers to determine if any major problems, work stoppages, or other issues developed that could affect the IRS' ability to process tax returns within established time periods and if any problems were being generated during the normal processing of

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<sup>1</sup> The BMF is the IRS' computer system that consists of federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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business tax returns that were surfacing during or adversely affecting other IRS processes.

- IX. Developed a computer program to identify U.S. Corporation Income Tax Returns (Forms 1120 and 1120-A) processed by the IRS between January 1 and September 7, 2002, claiming refunds. Our computer program also identified those corporate taxpayers whose refunds were processed as direct deposits.

**Major Contributors to This Report**

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**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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**Appendix III**

**Report Distribution List**

Acting Commissioner N:C  
Deputy Commissioner, Small Business/Self-Employed Division S  
Deputy Commissioner, Wage and Investment Division W  
Director, Customer Account Services, Small Business/Self-Employed Division S:CAS  
Director, Tax Forms and Publications, Wage and Investment Division W:CAR:MP:FP  
Director, Taxpayer Education and Communication, Small Business/Self-Employed Division S:T  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Office of Management Controls N:CFO:F:M  
Audit Liaisons:  
    Commissioner, Small Business/Self-Employed Division S  
    Commissioner, Wage and Investment Division W  
    Director, Customer Account Services, Small Business/Self-Employed Division S:CAS

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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### **Appendix IV**

#### **Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

##### Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; \$1,190,000 (see page 2).

##### Methodology Used to Measure the Reported Benefit:

As of August 10, 2002, the Internal Revenue Service (IRS) had processed a total of 25.3 million paper business tax returns in its 2 Business Submission Processing Centers. Approximately 3.6 million of those returns (14 percent) were filed in the wrong Submission Processing Center and had to be shipped to the Ogden or Cincinnati Centers for processing. The IRS estimates for all of Calendar Year (CY) 2002 that just over 42 million paper business returns will be processed in Ogden and Cincinnati. Applying this estimate to the percentage of returns that were misrouted as of August 10, 2002, we estimate that for CY 2002, the IRS will ship 5.88 million tax returns received in the wrong Submission Processing Center. IRS officials estimate a cost of \$30.36 per box to ship these returns.<sup>1</sup> On average, 300 tax returns will fit into a box for shipping. The total estimated cost to ship 5.88 million returns is, therefore, approximately \$595,000.

If, by taking our recommended actions, the IRS reduced the volume of misdirected business tax returns by a conservative 40 percent, it could save \$238,000 per year. Over 5 years, the IRS would save \$1,190,000.

We originally estimated that our recommended actions would reduce the volume of misdirected business tax returns by 50 percent. The IRS disagreed with this estimate stating that feedback received from the tax practitioner community indicated most of the misdirected tax returns were not the result of inaccurate “Where to File” instructions on the part of the IRS, but occurred because of the following taxpayer errors:

- Continued use of outdated envelopes containing the former “Where to File” address.
- Filing a taxpayer’s individual and business tax returns in the same envelope.

We revised our estimate to 40 percent and believe this estimate to be very conservative for the following reasons:

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<sup>1</sup> Estimated costs included only the cost to actually ship the documents. Associated labor costs were not estimated and were not included in our outcome measure.

**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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- Tax practitioners using outdated envelopes and filing individual and business tax returns in the same envelopes could certainly be doing so because they were not aware of the new addresses for filing business returns. (See the comment made by a tax practitioner on page 6.)
- Close to 40 percent of the misdirected tax returns were self-prepared. Taxpayers preparing these returns would be much less likely than tax practitioners to have outdated envelopes on hand or to be mailing multiple tax returns at the same time.

### **Sample Selection**

We selected judgmental samples<sup>1</sup> of 234 paper business tax returns<sup>2</sup> at various stages of processing at the 2 Business Submission Processing Centers to determine if the returns were processed correctly and if the information on the returns was accurately posted to the taxpayers' accounts on the Internal Revenue Service's (IRS) Business Master File (BMF).<sup>3</sup>

Our samples included 119 tax returns waiting to have data entered into IRS computers. These returns were selected as follows:

- We selected a total of 67 of these tax returns at the Cincinnati Submission Processing Center on March 6 and 7, 2002. The 67 returns included 4 each of 18 different types of business tax returns waiting to have data entered into IRS computers, with the following exceptions:
  - We selected four Generation-Skipping Transfer Tax Returns for Distributions (Form 706-GS[D]) on March 14, 2002.
  - We selected only two Occupational Tax and Registration Returns for Wagering (Form 11-C) because they were the only ones available. These two returns were selected March 12, 2002.
  - We selected only one Generation-Skipping Transfer Tax Return for Terminations (Form 706-GS[T]) because it was the only one available. This return was selected March 14, 2002.
- We selected a total of 52 of these tax returns at the Ogden Submission Processing Center on March 21 and 22, 2002. These 52 returns included 4 each of 13 different types of business tax returns waiting to have data entered into IRS computers.

Our samples included 115 tax returns routed to the IRS' Error Resolution function during processing. These returns were selected as follows:

- We selected a total of 63 of these tax returns at the Cincinnati Submission Processing Center from March 8 through May 15, 2002. These 63 returns included 4 each of the

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<sup>1</sup> Statistical sampling was not possible during our on-line review of processing because the universe of returns in any segment of the process changed from day-to-day. Statistical projections in this environment would have been impractical.

<sup>2</sup> Sixty of these returns were U.S. Corporation Income Tax Returns discussed on page 7 of the report.

<sup>3</sup> The BMF is the IRS' computer system that consists of federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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returns with 1 of 14 frequently occurring error codes. (We selected more than four returns for three of the error codes.)

- We selected a total of 52 of these tax returns at the Ogden Submission Processing Center from March 22 through April 9, 2002. These 52 returns included 4 each of the returns with 1 of 13 frequently occurring error codes.<sup>4</sup>

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<sup>4</sup> We selected the error codes for review from the Submission Processing Centers' Error Count Reports. From the weekly and cumulative reports, we identified the most frequently occurring error codes. However, we did not include error codes involving the entity section of the tax return, i.e., name, address, and taxpayer identification number.



**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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**Appendix VI**



**Business Tax Returns (Tax Year 2001) with  
Authorizations for Third Party Contact**

<b><u>Name of Form</u></b>	<b><u>Form Number</u></b>
• Employer's Annual Federal Unemployment (FUTA) Tax Return	940/940-EZ
• Employer's Quarterly Federal Tax Return	941
• Employer's Annual Tax Return for Agricultural Employees	943
• Annual Return of Withheld Federal Income Tax	945
• Farmers' Cooperative Association Income Tax Return	990-C
• Exempt Organization Business Income Tax Return	990-T
• U.S. Income Tax Return for Estates and Trusts	1041
• U.S. Return of Partnership Income	1065
• U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return	1066
• U.S. Corporation Income Tax Return	1120
• U.S. Corporation Short-Form Income Tax Return	1120-A
• U.S. Income Tax Return of a Foreign Corporation	1120-F
• U.S. Income Tax Return of a Foreign Sales Corporation	1120-FSC
• U.S. Income Tax Return for Homeowners Associations	1120-H
• U.S. Life Insurance Company Income Tax Return	1120-L
• U.S. Income Tax Return for an S Corporation	1120S
• U.S. Income Tax Return for Settlement Funds (Under Section 468B)	1120-SF
• Return for Nuclear Decommissioning Funds and Certain Related Persons	1120-ND
• U.S. Property and Casualty Insurance Company Income Tax Return	1120-PC
• U.S. Income Tax Return for Certain Political Organizations	1120-POL
• U.S. Income Tax Return for Real Estate Investment Trusts	1120-REIT
• U.S. Income Tax Return for Regulated investment Companies	1120-RIC

**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

Appendix VII

**Management's Response to the Draft Report**

 COMMISSIONER SMALL BUSINESS/SELF-EMPLOYED DIVISION	DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE WASHINGTON, D.C. 20224  DEC 12 2002	<b>RECEIVED</b> DEC 12 2002
 <b>MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION</b>		
<b>FROM:</b>	Joseph G. Kehoe  Commissioner, Small Business/Self-Employed Division	
<b>SUBJECT:</b>	Draft Audit Report # 2002-30-017 titled, "Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File"	
 <p>I have received your draft report titled, "Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File." Your report examined our need to aggressively publicize changes in filing locations for certain Business Master File (BMF) form types. I agree improvements are needed to ensure that taxpayers are provided accurate information on "Where to File", and have taken actions to address the issues you raised.</p> <p>Your report also examined our need to ensure that BMF taxpayers are aware of the direct deposit option for BMF refunds, and that we honor those BMF direct deposit requests. We have already made a number of changes to address this issue, and plan to take additional action.</p> <p>Although I agree with your recommendations to improve the accuracy and availability of "Where to File" information, I disagree with and cannot validate your estimate that ensuring the accuracy of the "Where to File" information for all BMF forms, as well as highlighting the filing location changes in tax packages and on the <i>IRS Digital Daily</i> web site would eliminate 50% of the misdirected filings. Based on the feedback received from the practitioner community, data shows that most of the misdirected tax returns were not the result of inaccurate "Where to File" instructions, but occurred based on the following:</p> <ul style="list-style-type: none"><li>• Continued use of outdated envelopes containing the former "Where to File" center's address.</li><li>• Filing a taxpayer's IMF and BMF tax returns in the same envelope.</li></ul>		

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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2

I agree with the report findings on the need to monitor the effectiveness of the revised processing procedures for the BMF direct deposit option. We have prepared programming requests to obtain the monitoring reports we need.

Our responses to the specific recommendations outlined in the report are as follows:

### **RECOMMENDATION 1**

The Director, Tax Forms and Publications, Wage and Investment (W&I) Division, should ensure that the following changes are made to IRS forms and publications:

- Update the instructions on where to file Forms 706-GS (D), 706-GS (D-1), 706-GS (T), and 709-A.
- Update the "Changes to Note" (or similar) section of the Forms 940 and 941 instructions to bring to the taxpayers' attention that there has been a change in filing locations.
- Indicate in the appropriate section of Publication 15 that there has been a change in filing locations for employment tax returns (Forms 940, 940-EZ, 941 943, and 945).

### **ASSESSMENT OF CAUSE**

We did not revise the instructions for Forms 706-GS (D), 706-GS (D-1), 706-GS (T), and 709-A to reflect the new filing location but instructed taxpayers to file their returns at one of the 10 IRS Centers. The "Changes to Note" sections of Forms 940, 940-EZ, 941, and 943 and Publication 15 did not mention the change in filing locations for business returns. Taxpayers may not have been aware of the address changes because many taxpayers filed a significant number of business returns at the wrong IRS address.

### **CORRECTIVE ACTION(S)**

Tax Forms and Publications, Wage and Investment Division will take (or has already taken) the following actions:

1. Revise the instructions for Forms 706-GS (D), 706-GS (D-1), 706-GS (T), and 709-A to update the filing addresses
2. Add an "Important Reminder" in the Form 940 instructions to remind taxpayers of the new filing locations for business returns

**Business Tax Returns Were Successfully Processed in Two Locations  
in 2002; However, Taxpayers Need More Information on Where to File**

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3

3. Add a reminder to the Form 941 about using the addresses for business returns on the back of the form
4. Add an "Important Reminder" in Publication 15, Circular E, and Employer's Tax Guide to remind taxpayers of the new filing locations for business returns

**PROPOSED IMPLEMENTATION DATE(S)**

1. Forms 706-GS (D), 706-GS (D-1), and 706-GS (T): December 31, 2002;  
Form 709-A: Completed October 29, 2002
2. Form 940: December 15, 2002
3. Form 941: January 31, 2003
4. Publication 15: Completed November 30, 2002

**RESPONSIBLE MANAGEMENT OFFICIAL(S)**

Director, Tax Forms and Publications, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 2**

The Director, Customer Account Services, SB/SE Division should continue to monitor the volumes of Forms 940-EZ and 943 filed in the wrong Submission Processing Centers during CY 2003 and, if the volumes remain significant, work with the Director, Tax Forms and Publications, W&I Division, to obtain updates to the "Changes to Note" (or similar) sections of these forms similar to those obtained for Forms 940 and 941.

**ASSESSMENT OF CAUSE**

The "Changes to Note" sections of Forms 940-EZ and 943 did not mention the change in filing locations for business returns. Taxpayers may not have been aware of the address changes because many taxpayers filed a significant number of business returns at the wrong IRS address.

**CORRECTIVE ACTION(S)**

The Submission Processing Program Management/Process Assurance (PMPA) Branch within Customer Account Services, SB/SE Division, will continue to monitor the volumes of transshipped work by form type (including Forms 940-EZ and 943). If volumes appear to warrant additional action for tax year 2003 Forms 940-EZ and 943, the PMPA staff will coordinate with Tax Forms and Publications, W&I Division, to obtain updates to

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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4

the "Changes to Note" (or similar) sections of these forms similar to those obtained for Forms 940 and 941.

### **PROPOSED IMPLEMENTATION DATE(S)**

1. Continue transshipping monitoring; Ongoing
2. Assess taxpayer adherence to filing instructions and coordinate with Tax Forms and Publications, W&I Division (if necessary): July 1, 2003

### **RESPONSIBLE MANAGEMENT OFFICIAL(S)**

Chief, Submission Processing Program Management/Process Assurance Branch, Small Business/Self-Employed Division

### **CORRECTIVE ACTION MONITORING PLAN**

All submission processing centers must complete a transshipping template weekly to provide data on the number of misdirected returns, by form type. The submission processing center transshipping coordinators email the template to the Headquarters PMPA staff. The PMPA staff consolidates the data as necessary for further analysis.

### **RECOMMENDATION 3**

The Director, Taxpayer Education and Communication, SB/SE Division, should ensure that paper business return filing locations are provided on the appropriate pages of the *IRS Digital Daily* web site as well as in other appropriate IRS educational materials. At a minimum, each web page related to business tax returns should include a link to the information included on the "Tax Professional" web page.

### **ASSESSMENT OF CAUSE**

The *IRS Digital Daily* web site does not provide sufficient "Where to File" instructions for business filers.

### **CORRECTIVE ACTION(S)**

A workgroup is consolidating the "Around the Nation," "Contact Us" and "Where to File" information on the IRS web site, [www.irs.gov](http://www.irs.gov). In order to address the "Where to File" problem immediately, while allowing the work group to continue defining the long term solution, we will change the Where to File area of the site to include the Business Where to File information, in addition to the Individual Where to File information currently on that page. This "Where to File" link on the Navigation Bar appears on all [irs.gov](http://irs.gov) pages, which means that taxpayers can access the Business Where to File

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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5

information from any page on the site. Taxpayer Education and Communication (TEC), SB/SE Division, has obtained agreement from all the necessary Operating Divisions in order to implement this change. The Public Portal Office (PPO) and SB/SE, TEC are working to implement these changes in the irs.gov update tool.

### **PROPOSED IMPLEMENTATION DATE(S)**

January 1, 2003

### **RESPONSIBLE MANAGEMENT OFFICIAL(S)**

Director, Taxpayer Education and Communication, Small Business/Self-Employed Division

### **CORRECTIVE ACTION MONITORING PLAN**

N/A

### **RECOMMENDATION 4**

The Director, Customer Account Services, SB/SE Division should gather data to determine whether the actions taken to change processing procedures resolved or significantly improved the problem of IRS employees overlooking requests for direct deposit of refunds or whether additional improvements need to be made. This issue should also be addressed in training for processing employees.

### **ASSESSMENT OF CAUSE**

Few corporate taxpayers selected the direct deposit option for corporate refunds in 2002. Further, we did not honor many direct deposit requests on corporate returns that taxpayers submitted. We did not release Form 8050 to the public until late February 2002, decreasing public awareness and use of the direct deposit request form. In addition, the sequencing information in the Code & Edit procedures was incorrect until June 14, 2002, causing employees to place the Form 8050 in the incorrect order within the corporate tax return submission. This contributed to data transcriber inability to identify and transcribe Form 8050 in at least some cases.

### **CORRECTIVE ACTION(S)**

To address these issues, we:

1. Issued two National Office Alerts to address deficiencies in the Code & Edit procedures related to Form 8050: Alert SBSE-IA-2002-240 on June 14, 2002, to correct the sequencing of Form 8050 within the corporate tax submission and

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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6

Alert SBSE-IA-2002-317 on October 24, 2002, to address Form 8050 within the Code & Edit Attachment Guide.

2. The 2003 version of IRM 3.11.16, Form 1120 Code & Edit Instructions, has been changed with the new sequencing information. The Headquarters 1120 analyst will observe and participate in Code & Edit training at one of the two submission processing centers performing Form 1120 processing. Among other things, he will ensure sequencing of Form 8050 gets the proper emphasis. IRM 3.11.16 is the main training document for Form 1120 Code & Edit.

### **PROPOSED IMPLEMENTATION DATE(S)**

1. Completed June 14, 2002, and October 24, 2002
2. February 28, 2003

### **RESPONSIBLE MANAGEMENT OFFICIAL(S)**

Director, Customer Account Services, Small Business/Self-Employed Division

### **CORRECTIVE ACTION MONITORING PLAN**

N/A

### **RECOMMENDATION 5**

The Director, Customer Account Services, SB/SE Division should monitor the volume of corporate taxpayers selecting the direct deposit option. If the number does not significantly increase after steps are taken to ensure that all direct deposit requests are properly processed, the Director should work with the Director, Tax Forms and Publications, W&I Division, to make appropriate changes to Forms 1120 and 1120-A necessary to ensure that corporate taxpayers are aware of, and can easily select, the direct deposit option. Consideration should be given to including the direct deposit option on the Forms 1120 and 1120-A in the future.

### **ASSESSMENT OF CAUSE**

Few corporate taxpayers selected the direct deposit option for corporate refunds in 2002. We did not honor many direct deposit requests on corporate returns that taxpayers submitted. We did not release Form 8050 to the public until late February 2002, decreasing public awareness and use of the direct deposit request form. In addition, the sequencing information in the Code & Edit procedures was incorrect until June 14, 2002, causing the employees to place Form 8050 in the incorrect order within

## **Business Tax Returns Were Successfully Processed in Two Locations in 2002; However, Taxpayers Need More Information on Where to File**

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7

within the corporate tax return submission. This contributed to data transcriber inability to identify and transcribe Form 8050 in at least some cases.

### **CORRECTIVE ACTION(S)**

We submitted a Request for Information Services (RIS) TSF-1-0046-A00 to the Modernization, Information Technology and Security Services (MITS) Division on December 1, 2000, to request programming to capture direct deposit data from the Business Master File. This programming will give us the number of taxpayers requesting direct deposit on a corporate return, the total amount of direct deposit refund dollars issued, and related data.

### **PROPOSED IMPLEMENTATION DATE(S)**

January 1, 2003

### **RESPONSIBLE MANAGEMENT OFFICIAL(S)**

Director, Customer Account Services, Small Business/Self-Employed Division

### **CORRECTIVE ACTION MONITORING PLAN**

The RIS author and SB/SE Customer Account Services management will monitor the reports requested in RIS TSF-1-0046-A00. If volumes do not rise significantly, SB/SE CAS will coordinate with SB/SE TEC to increase taxpayer awareness of the direct deposit option.

If you have any questions about this response, please contact C. John Crawford, Director, Customer Account Services, Small Business/Self-Employed Division, at (972) 308-7010, or John R. Parker, Chief, SP Program Management Process Assurance, at (859) 669-5561.